

2004 OPINIONS LAW DEVELOPMENTS

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A. Bar Association Reports.

California State Bar 2004 Report on Remedies Opinions:

In September 2004, the State Bar of California Business Law Section published its *Report On Third-Party Remedies Opinions*, currently available on the Business Law Section's web page:

http://www.calbar.ca.gov/calbar/pdfs/sections/buslaw/opinions/2004-09_remedies-opinion.pdf.

The report is a product of a review from the ground up of the section's approach to the remedies opinion and is the first in well over a decade. The report reflects several important developments in the opinions practice since the section's 1989 report on legal opinions and its 1992 response to the ABA Accord. These include the publication of the TriBar Opinion Committee's 1998 report on third-party closing opinions, the ABA's 1998 Legal Opinion Principles and 2002 revised Guidelines for the preparation of closing opinions, and the American Law Institute's Restatement (Third) of the Law Governing Lawyers (2000). It endorses the adoption by those publications of "customary practice" as the basic yardstick to apply to the giving and understanding of third-party legal opinions.

Major issues addressed by the report include (1) threshold issues (such as when remedies opinions should be requested—or given); (2) whether California courts and New York courts really treat the enforcement of contracts differently; (3) the reconciliation of the California approach to the scope of the remedies opinion with the approach adopted by TriBar Opinion Committee; and (4) the need to include express exceptions with respect to many contract provisions that law firms have commonly included in their "laundry lists" of exceptions when rendering remedies opinions.

New reports by the Corporations Committee relating to aspects of giving and receiving third-party legal opinions not addressed by the Report on Remedies Opinions and by the UCC Committee addressing opinions relating to security interests under Revised Division 9 are nearing completion, and are expected to be published in the first half of 2005.

TriBar Report, 59 *The Business Lawyer* 1483, August 2004:

This report (Special Report of the TriBar Opinion Committee: The Remedies Opinion—Deciding When to Include Exceptions and Assumptions) addresses, among other things, customary practice in general with respect to the inclusion of exceptions to the remedies opinion. It then addresses several common contractual provisions: requiring the payment of interest on overdue interest; providing for late charges, default interest, liquidated damages or other economic remedies; waiving the right to a jury trial; prohibiting oral modifications; providing for the law of a given jurisdiction to govern the contract; and specifying the forum in which any actions regarding the contract are to be brought.

Special Report of the TriBar Opinion Committee: U.C.C. Security Interest Opinions – Revised Article 9, 58 *The Business Lawyer* 1453, August 2003:

The title of this report speaks for itself.

The Committee on Legal Opinions, ABA Section of Business Law, Law Office Opinion Practices, 60 *The Business Lawyer* 327, November 2004:

This article reports on responses to a questionnaire circulated by the committee to its more than 300 members regarding their firms' and departments' opinion policies and procedures. It also discusses the standards of care and competence applicable to the rendering of third-party legal opinions: "[a]n opinion giver . . . has the responsibility to know customary practice—that is, of knowing the practice normally followed by lawyers who regularly give opinions and lawyers who regularly advise opinion recipients regarding opinions of the kind involved"; "[f]irms and departments that give or receive closing opinions have a responsibility to see that those involved in opinion practice are competent to engage in that practice and understand the ethical context in which third party opinions are given—i.e., that they are familiar not only with customary opinion practice, "but also relevant opinion literature, and the policies and procedures of their firm or department."

The article reports that the level of formal instruction regarding opinions and the provision of form opinions and explanatory materials varies widely, and that firms and departments "make only modest efforts to maintain files of opinions given and received in a manner



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that facilitates later reference to them,” or “to review opinions after they are given to see if policies were observed.” It stresses that firms and departments “have the responsibility to maintain the quality of the legal opinions they deliver and the quality of their review of those they receive,” and recommends that they periodically review their policies to help them maintain quality in their legal opinion practice.

B. Cases Addressing Third-Party Legal Opinions.

In re Enron Corp., et al. (Bankr.S.D.N.Y. 2003) Case No. 01-16034 (AJG), *Final Report of Neal Batson, Court-Appointed Examiner*.

Assessing the specific roles of various attorneys to Enron entities and their potential liability for issuing legal opinions that were misleading, Neal Batson, the court-appointed examiner for the Enron bankruptcy, criticized Vinson & Elkins for:

(a) “true issuance” opinions delivered in connection with certain FAS 140 transactions despite the firm’s alleged knowledge that (i) the opinions did not address the “critical issues under FAS 140, as Vinson & Elkins understood those issues”; (ii) Enron’s accountants were using the opinions to support Enron’s financial reporting; and (iii) the transactions were significant to Enron’s earnings; and

(b) a true sale opinion delivered in connection with a transaction for which a valid business purpose was essential, even though Vinson & Elkins allegedly knew that there was no valid business purpose for the transaction.

Batson also criticized Andrews & Kurth for delivering true issuance or true sale opinions in connection with several FAS 140 transactions despite concerns about several terms in the transactions that created questions about whether a sale had occurred.

Reich Family LP v. McDermott, Will & Emery 101921-03 (New York Supreme Court).

McDermott, Will & Emery delivered a third-party legal opinion, in connection with Reich Family LP’s making of an investment in SpectruMedix Corporation, to the effect that the investment had been properly authorized by SpectruMedix’s board of directors. One of SpectruMedix’s directors at the time, Joseph Adlerstein, was removed from the board at the same meeting at which the investment was authorized (the new investors were issued stock with voting rights that gave them control of the company and enabled them to remove him). He brought a lawsuit challenging the transaction. In that lawsuit, *Adlerstein v. Wertheimer* (2002) Del.Ch. Lexis 13, the court held that Adlerstein had not been given advance notice of the proposed transaction, and invalidated the board’s approval of the Reich Family LP investment. The court based its conclusion on

Adlerstein’s status as both a director and the controlling shareholder of SpectruMedix: his being kept in the dark about the plans of the other two directors prevented him from exercising his right, as controlling shareholder, to remove them and to prevent the transaction from taking place.

Reich Family LP then sued McDermott, Will & Emery based on its erroneous opinion regarding the due authorization of Reich Family LP’s investment in SpectruMedix, alleging, among other things (a) malpractice; (b) negligent misrepresentation; and (c) breach of fiduciary duty. The law firm moved to dismiss the complaint; the court denied the motion to dismiss, holding that even in the absence of contractual privity, a party can assert claims of both malpractice and negligent misrepresentation against an attorney where “there is an awareness that an attorney’s statement is to be used for a specific purpose, reliance on the statement, and some conduct linking the attorneys to the non-client evincing their understanding of that reliance.”

The court also held that the equitable principles limitation did not spare McDermott, Will & Emery from liability; that limitation, it stated, “applies by its terms to issues of good faith and fair dealing between the parties to the agreement,” not to questions of due authorization of a client’s entry into the agreement.

Dean Foods Company v. Pappathanasi et al. (Mass.Sup. 2004) WL 3019442.

Rubin & Rudman, LLP delivered an opinion letter to the acquiror in connection with its acquisition of Rubin & Rudnick client West Lynn Creamery. The firm’s opinion stated that, to its knowledge, among other things, there existed no pending or threatened investigations involving West Lynn Creamery. The opinion letter stated that, for purposes of that opinion, the firm had relied upon the factual representations of its client made in the underlying stock purchase agreement, without independent investigation, but stated that “nothing has come to our attention which causes us to doubt the accuracy thereof.”

In fact, however, West Lynn Creamery had earlier been asked, in October 1997, to respond to a federal criminal grand jury investigation relating to payments made to one of their customers, and Rubin & Rudman had been asked by West Lynn Creamery to represent it in connection with the subpoena. At the time the opinion was issued, on June 30, 1998, six months had passed since the Rubin & Rudnick attorney in charge of the grand jury investigation had received any communication with respect to the investigation. In discussions with some of the firm’s client shareholders as to

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whether the investigation should be disclosed to the acquiror, that attorney said that he had not heard from the Assistant U.S. Attorney conducting the investigation for nearly six months, and that, based on his prior experience in representing clients in tax evasion cases, it was his “guesstimate” that the matter had “probably gone away.” Although the attorneys advised their client to disclose the investigation, the client demurred, fearing that disclosure would create problems among his fellow shareholders. A few months after the closing, West Lynn Creamery was made the target of a federal grand jury investigation arising out of the prior investigation of its customer. It ultimately pled guilty and paid a fine of \$7.2 million.

Following a court trial, the Superior Court for the Commonwealth of Massachusetts awarded \$7.2 million in damages against the defendants. Citing the Restatement (Third) of the Law Governing Lawyers and the 1998 TriBar Opinion Committee Report on third-party closing opinions, the court found Rubin & Rudman liable for negligent misrepresentation, based on its failure to conform to customary practices of due diligence in connection with the issuance of its opinion: the firm had failed to follow its own policies with respect to due diligence for legal opinions, the reviewing partner had not been informed of the pending investigation, and the attorney representing West Lynn Creamery in connection with the investigation was part of the “knowledge” group and had not been made aware that his “guesstimate” would be used as the basis for the legal opinion that was rendered, rather than for purposes of determining whether the investigation should be included on a disclosure schedule to the stock purchase agreement.

National Bank of Canada et al. v. Hale & Dorr LLP (Mass.Sup. 2004) 17 Mass.L.Rptr. 681:

This case also addressed the failure of a law firm rendering a third-party legal opinion in connection with a loan to refer to a pending material action—a patent infringement case in which several lawyers from the defendant law firm were representing the borrower. The defendant law firm had stated that, “to its knowledge,” there was no action, suit, proceeding or investigation pending or threatened against its client that, if decided adversely to it, could have a material adverse effect upon it; “knowledge” was defined as the “conscious awareness” of the attorneys in the defendant firm “who have rendered substantive attention to [its client] of the existence or absence of any facts which would contradict” its opinions.

The court granted the defendant summary judgment on the plaintiff’s causes of action alleging negligent misrepresentation and negligence. It held that “an attorney has no duty to a nonclient

where the nonclient has potentially conflicting interests with that of the attorney’s client,” and that since the borrower (the firm’s client) and the banks (the addressees of the opinion letter) were on opposite sides of the loan transaction, there were competing interests that negated a duty of the law firm to the banks. The court also granted the defendant’s motion for summary judgment on the direct breach of contract claim, holding that there was no contract between the law firm and the banks, but it let stand causes of action alleging breach of contract rights to third-party beneficiaries—finding the recipients of the opinion to be intended beneficiaries of the contract between the defendant and its client—and misrepresentation, which requires only “the false statement of a material fact made to induce the plaintiff to act, together with reliance on the false statement by the plaintiff to the plaintiff’s detriment.”

Wafra Leasing Corporation v. Prime Capital Corporation et al. (N.D.Ill. 2002) 192 F.Supp.2d 852:

The plaintiff invested in a securitization of financial contracts by Prime Capital Corporation, and its investment went bad. The defendant law firm’s opinion, given at the closing of the transaction, had stated that “no information has come to our attention which would give us actual knowledge or actual notice [that] any . . . of the foregoing documents, certificates, reports and information on which we have relied are not accurate and complete.” Plaintiff alleged that the defendant had such knowledge, and a cause of action based on the alleged misrepresentation was allowed to stand.

In re Enron Corporation Securities, Derivative & ERISA Litigation (S.D.Tex. 2002) 235 F.Supp.2d 549:

Investors could state a securities act section 10(b) claim against a law firm by alleging that the firm participated in the creation of the special purpose entity used in a transaction, drafted true sale opinions with respect to the transfers involved in the transaction, and drafted false SEC filings and press releases. They could not, however, state such a claim against a second law firm that was alleged only to have represented the special purpose entities. ■